IMF SURVEY
A PUBLICATION OF THE INTERNATIONAL MONETARY FUND
November 29, 1993

New Currencies Need the Support Of Sound Policies

The decision by a state of the former Soviet Union to leave the ruble area and introduce its own currency poses a major challenge. Success requires a clear consensus about the desired goals, as well as the political will and technical ability to implement supporting economic and financial policies. Experience has shown that the benefits from such a currency reform can be substantial and can come surprisingly rapidly if accompanied by concerted measures to support rapid economic stabilization. Conversely, in the absence of such policies, the outcome can be substantially worse than if no new currency had been introduced.

What are the necessary elements for a successful introduction of a national currency? The experiences of five states of the former Soviet Union that have introduced independent currencies—Estonia, the Kyrgyz Republic, Latvia, Lithuania, and Ukraine—are cases in point.

These countries left the ruble area before the withdrawal of pre-1993 rubles in Russia in July 1993 (see box on page 362), hoping to achieve several goals:

- To establish monetary and financial independence from Russia and the rest of the former Soviet Union. This was prompted by the countries' desire to take firm control over their economic fate and to reinforce their newly gained political independence.
- To use this policy independence to achieve financial and monetary stability, broadly defined as bringing inflation under control and attaining a degree of stability for the exchange rate vis-à-vis "hard" currencies. This goal was particularly compelling because of sustained high *(Please turn to page 360)*

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Camdessus on Trade

Speaking on global trade policy to a trade symposium in Monterrey, Mexico, on October 29, IMF Managing Director Michel Camdessus discussed the importance of free trade for the world economy. He stated that all avenues toward trade liberalization—unilateral, regional, and multilateral—have useful roles to play but emphasized that trade liberalization can realize its full benefits only in the context of an open and robust multilateral trading system, and only if supported by sound economic policies. See page 354 for excerpts.

READEX

SELECTED TOPICS

Trade Liberalization, Supported by Good Macro Policies, Is Critical for Global Growth

Following are excerpts of an address by IMF Managing Director Michel Camdessus delivered on October 29 at the Second Symposium on International Trade, held at the Instituto Tecnológico y de Estudios Superiores de Monterrey, in Monterrey, Mexico:

Trade policy has an unusually important role to play at the present juncture of world economic developments. Openness to trade helps ensure that producers and consumers base their decisions on prices reflecting true costs; and, through competition, it promotes production according to comparative advantage, thereby contributing to the efficient allocation of resources. It also promotes growth through the exploitation of economies of scale, and by fostering dynamic responses to changing circumstances. Moreover, it provides an external discipline that supports good policies.

We can never afford to forget the disastrous "beggar-my-neighbor" policies in the areas of trade and exchange relations that contributed to the economic problems of the period leading up to World War II and led to the establishment of the Bretton Woods institutions—the IMF and the World Bank—and the GATT [General Agreement on Tariffs and Trade].

In the early postwar decades, major reductions in trade and exchange restrictions were achieved under the auspices of the GATT and the Fund. At the same time, there was a widespread move among industrial countries toward currency convertibility for current account transactions. What was the result? From the late 1940s to the early 1970s, the industrial countries experienced growth of both trade and output that was virtually unprecedented and that has since been unmatched.

In recent years it is developing countries like Mexico—countries that have accepted the challenge of adjustment and reform—that have been setting examples for the world by turning away from import substitution and inward-oriented strategies that had been shown to fail, and adopting outward-oriented strategies instead. More than twenty developing countries, including Mexico, have joined the GATT in the past decade, and many have taken unilateral action to reduce their trade and exchange restrictions as part of comprehensive adjustment and reform strategies supported by the IMF and the World Bank. Mexico, of course, initiated a major liberalization of its trade system in the mid-1980s involving a marked reduction in tariffs and nontariff barriers. The results of the reforms in the developing countries are there for all to see. Between 1961 and 1975, the volume of exports of non-oil developing countries grew at half the pace of exports by industrial countries; but this relationship has since been reversed, so that, for instance, between 1986 and 1992 exports of non-oil developing countries grew at an average annual rate of 10 percent, compared with 5 percent for industrial countries.

And when developing countries are classified according to their trade strategies, it becomes clear which have been the most successful. Between 1986 and 1992, real GDP in strongly outward-oriented developing countries grew at an average rate of 7½ percent, and in moderately outward-oriented countries, by 5 percent. In contrast, countries with inward-oriented strategies saw average growth of only 2½ percent a year. In fact, the dynamism of the outward-oriented, successfully adjusting countries has not only strengthened the foundations of their own economies but has also been providing crucial support for global growth during the current weakness of activity in the industrial world.

Countries in transition from central planning to market-based economic systems bear the deepest scars of failed inward-looking policies. Rigid trade and payments restrictions, and the discriminatory and distortionary arrangements of the Council for Mutual Economic Assistance (CMEA), isolated these countries from the competitive forces of world markets. They contributed to the legacy of obsolete capital stocks and profoundly inefficient production that these countries have been trying to overcome through transformation.

The countries of Central Europe and the Baltics made early liberalization of their trade and exchange systems a major part of their efforts to adopt market principles and to inject rational prices and competition into their economies. Fundamental reforms were undertaken to reduce trade restrictions and to move toward current account convertibility. Substantial, though less extensive, reforms have also been carried out in Russia and other countries of the former Soviet Union.

In all these countries, the initial stages of transformation saw substantial declines in output, which were to a large extent an unavoidable consequence of the necessary reorientation of economic activity, industry, and trade. But where the liberalization of trade and payments has been accompanied by effec-

tive macroeconomic stabilization and by the domestic reforms required for markets to work, positive results have become visible. Thus, positive output growth, partly led by exports, is expected this year in a number of countries in Central Europe. Also, impressive progress has been made by a number of countries in transition in Asia on the basis of outward-oriented strategies, China being the outstanding example.

There is another reason why trade policy deserves emphasis at the present time: the unfortunate shift toward defensive trade policies by the industrial countries over the past decade and more. Weak growth, high and rising unemployment, and large external imbalances have all played their part in increasing protectionist pressures; and as a result there has been a proliferation of new nontariff barriers, including quotas and "voluntary" export restraints, as well as an increased resort to countervailing and anti-dumping measures. Protectionist pressures and interest in managed trade have increased further as a result of weak growth and joblessness in the recent recession. Yet we know that protection and resistance to competition and change are among the major impediments to stronger growth. This is truly a most vicious economic circle—defensive measures feeding on economic weakness, and economic weakness being exacerbated in turn by the ensuing protection.

Monterrey, Mexico. IMF Managing Director Michel Camdessus addressed the Second Symposium on International Trade on October 29.

The world must break out of this circle and embrace competition and free trade. This is clear. But what is the best way to do it? First, trade liberalization needs to be supported by policies across the whole range of macroeconomic, structural, and social areas. Liberal trade and sound macroeconomic, structural, and social policies are all indispensable partners in any coherent strategy for high-quality growth. This has been well understood in Mexico.

Sound fiscal and monetary policies can help ensure that a country's balance of payments and reserves are sufficiently strong to withstand the short-term pressures that may arise as a result of liberalization. Also, by helping to stabilize activity and employment, they can help prevent the emergence of protectionist pressures of the kind we have seen in the industrial countries in the recessions of the past decade.

Structural policies have an especially important role to play. By improving the functioning of markets and the flexibility of the economy, they can minimize the short-term costs of adjustment both to freer trade and to the constantly shifting forces of global competition in an open economy. Policies to improve the flexibility of labor markets, so that structural unemployment is reduced to a minimum, are particularly important. In the many industrial countries where structural unemployment has grown to unacceptable levels, there is greater recognition of the need to take action, albeit still too timid, to reform unemployment insurance schemes, promote job search and wage flexibility, limit taxes and regulations that discourage employment, and devote more resources to training and retraining.

But adjustment and structural change are bound to give rise to temporary costs, and some of those who bear them will not have adequate resources to defend themselves. This is where social policies must play their role—in ensuring that adequate, well-targeted, and cost-effective social safety nets exist to protect the poor and vulnerable.

Appropriate policies in all these areas should be in place to minimize the temporary costs of change, and thus to minimize the defensive resistance to liberalization and competition. The IMF makes every effort to ensure that these considerations are reflected in its policy advice to all member countries. This is evident in the comprehensive adjustment and reform programs that have been adopted in recent years by Mexico and many other developing and transforming countries with the support of the Fund.

Second, all avenues to trade liberalization—unilateral and regional, as well as multilateral—have useful roles to play, but liberalization by any route can realize its full benefits only in the context of an open and robust multilateral system.

• Unilateral liberalization: Mexico, of course, has made great progress along this route. Unilateral liberalization offers the advantage of immediate benefits from freer trade without any need for international negotiations, but it is also necessarily subject to the strongest domestic resistance from sectoral interests that have been put in a privileged position by protec-

tion. This is why the unilateral route to liberalization has been virtually unexploited by the industrial countries in recent years, although there are a few exceptions, notably Australia, New Zealand, and Sweden.

• Regional trade agreements—such as those negotiated by Mexico with other Latin American countries in recent years, and, of course, NAFTA—among a limited group of countries can provide their members with many benefits similar to those of multilateral liberalization, in terms of trade creation, the expansion of markets and the creation of new opportunities for economies of scale, and support for good policies. They are also easier to negotiate than multilateral agreements because of the smaller number of players. Moreover, they can in principle—and have in practice—set new standards for multilateral agreements and spur them on.

But regional trade agreements also carry dangers. In addition to creating trade among the members of the arrangement, they divert trade away from countries outside by discriminating against them, to the detriment of global efficiency and to the cost of nonmembers. They can also distract attention from efforts at multilateral liberalization. All this means that it is impossible to make a general judgment about the net benefits of regional arrangements: each must be judged in terms of its specific provisions and their implementation. One of the key questions is whether an agreement is consistent with the multilateral system and essentially outward-looking, or a defensive device that damages third parties, and ultimately the participants themselves.

In practice, some regional arrangements have been successful but others unsuccessful. The outstanding example of successful progress toward integration is surely the European Community, in spite of its many difficulties. The consensus of a number of studies is that in the EC, trade creation has far outweighed trade diversion and that diversion has been significant only in those sectors—such as agriculture and textiles—where multilateral liberalization has stalled. Estimates suggest that average real incomes in the EC have been raised significantly by regional integration and will be raised further with the completion of the single market. But the EC also has severe structural problems in a number of important areas, including agriculture and labor markets, that remain to be tackled.

The most spectacular example of damage and failure is, of course, the CMEA system of managed trade, but other regional arrangements, including some in Latin America, effectively extended the restrictive trade policies of their member countries and eventually foundered.

NAFTA should exert a positive influence by virtue of the outward orientation of its members' trade policies. Most studies have shown that trade liberalization under the Agreement will raise net welfare in all three member countries; and Mexico could be the main beneficiary. This is quite apart from the value of the Agreement in ensuring the stability of the trade policies of the member countries toward each other, which many—myself included—view as a key aspect of the Agreement. The fact that NAFTA entails no increase in tariffs or other restrictions against third countries is obviously essential and welcome, but the Agreement will result in some trade diversion, which may be significant in certain sectors, and which may adversely affect some neighboring countries. However, as long as member countries maintain the outward orientation of their trade policies, the boost to regional growth that NAFTA will provide will surely support trade and growth globally.

A quick conclusion of the Uruguay Round is the highest priority for economic policy in the world today.

But neither NAFTA nor any other regional arrangement can realize its full benefits without a strengthened multilateral trading system. It is crucial that the decisive actions needed to bring the Uruguay Round to a successful conclusion by the end of the year be taken now, so that the multilateral system is strengthened and multilateral liberalization takes a further stride forward. Only through the Uruguay Round can we reverse the protective measures taken by the industrial countries in recent years; there is no other way to extend the GATT's nondiscriminatory trade rules to sectors such as agriculture, textiles, and services; and no other way to prevent the further escalation of defensive measures.

The Uruguay Round is critical for developing countries and countries in transition because of the access they need to markets in the industrial world, but all countries stand to gain. Recent studies suggest that completing the Round as now envisaged would raise global real income permanently by more than $200 billion in 1992 prices, or by about ¾ of 1 percent. And if the Round were to fail, not only would such a benefit be forgone, but there would also be costs arising from the damage to confidence and deterioration in trade relations that would surely ensue.

Courageous and visionary decisions need to be made quickly to conclude the Uruguay Round and thereby contribute to a return to substantial and sustainable economic growth. This is the highest priority for economic policy in the world today.

Baltic States Make Progress With Stabilization and Structural Reform

Estonia, Latvia, and Lithuania have adopted consistent policy strategies and implemented them quickly and with determination. This has enabled them to make considerable progress toward both stabilizing and restructuring their economies. The following article is excerpted from a box entitled "Stabilization and Economic Reform in the Baltic Countries" that appeared in the October 1993 World Economic Outlook.

In mid-1992, the Baltic states were faced with serious macroeconomic imbalances traceable to two major supply shocks. The collapse of the socialist command economy had caused major disruptions in trade, payments, and monetary arrangements with the countries of the former Soviet Union; and the move by Russia toward world market prices for oil and raw material exports to the Baltic countries implied a permanent loss in real national income of over 20 percent of GDP. The Baltic countries responded to these shocks by rapidly implementing stabilization and reform policies, which were supported by financial arrangements with the IMF that were approved in September and October 1992. [Additional IMF financial arrangements with Estonia and Lithuania were approved in October 1993.]

From mid-1992 to mid-1993, the Baltic countries made substantial progress toward establishing macroeconomic stability. Inflation decelerated rapidly, particularly in Latvia and Estonia, and real incomes declined to reflect the new relative prices and productivity levels. This process was associated with unavoidable losses in output and employment. Recent data on industrial output and emerging private sector activities suggest, however, that the output decline is bottoming out, although unemployment is still expected to rise with the ongoing restructuring of industry.

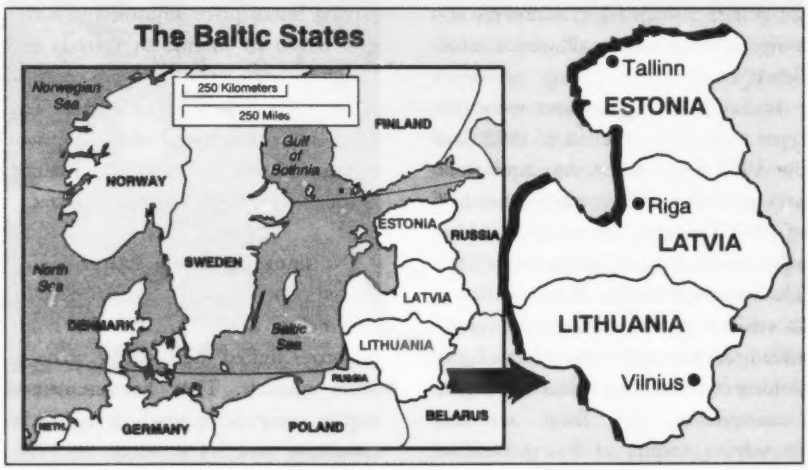
The most urgent policy tasks at the beginning of the adjustment process were to realign domestic prices with world prices, to adjust real wages to the terms of trade shock, and to prevent hyperinflation. The reform programs in all three countries incorporated rapid completion of price liberalization and the elimination of subsidies and subsidized loans. Thereafter, the monthly inflation rate was targeted to slow gradually to 2–3 percent by mid-1993 and to approach Western European levels over the longer run.

To insulate themselves from inflationary impulses from the other states of the former Soviet Union, the Baltic countries introduced their own currencies at an early stage of the adjustment process. Estonia established a currency board and pegged its exchange rate to the deutsche mark to provide a strong anchor for the price system. [See related story on page 366 of this issue.] Latvia and Lithuania, in contrast, established a traditional central banking system and allowed their currencies to float, relying on monetary policy restraint to achieve price stability.

Corrective Policies Show Results

In Estonia and Latvia, monetary developments indicate strong commitment toward inflation control. Money supply growth has lagged far behind inflation, and real interest rates have become positive. Estonia's currency board arrangement encouraged strong confidence from the outset; the exchange rate of the kroon has remained fixed against the deutsche mark, and international reserves of the Bank of Estonia have increased steadily.

Latvia's central bank has achieved similar results through tight control of the monetary base. The exchange rate strengthened after an initial depreciation, and more recently the Bank of Latvia lowered its refinancing rate to arrest the appreciation of the currency.



Monetary policy in Lithuania has been significantly easier than in Latvia because of large inflows through correspondent accounts with the central banks of the former Soviet Union and because of a lack of confidence caused by the drawn-out process of changing administrations. Monetary policy in Lithuania was tightened sharply in May 1993, however, and the exchange rate, which had depreciated rapidly against convertible currencies, has started to appreciate.

Fiscal stabilization was another integral part of these countries' transformation efforts. For the year that began in mid-1992, Estonia and Lithuania aimed for a balanced general government budget despite a sharp fall in economic activity, whereas Latvia allowed a small deficit.

In Latvia, fiscal measures were delayed until late in the fall of 1992, and the 1992 fiscal deficit was equivalent to 1 percent of GDP; in the first half of 1993, however, there was a surplus equivalent to ½ of 1 percent of GDP. The Lithuanian authorities, also facing shortfalls in revenues, raised the value-added tax rate and moved to cash rationing to maintain a balanced budget. Consequently, the fiscal accounts recorded a surplus of 2¼ percent of GDP in 1992, and the budget balance is expected to be only slightly negative in 1993. Financial policies were supported by incomes policies, which were introduced in slightly different variants in all three countries.

Structural Reforms

A key aspect of all the stabilization programs in the Baltic countries was trade liberalization. Before the reform process started, 95 percent of the foreign trade of the Baltic countries was with the former Soviet Union. To open their economies to free trade and global competition, all three countries abolished most trade restrictions, established current account convertibility, and liberalized most capital account transactions during the course of 1992.

Financial sector reform has helped to improve the efficiency of financial intermediation by creating two-tier banking systems, introducing prudential banking supervision practices, strengthening banks' capital bases, and establishing interbank markets. All three governments also committed themselves to put in place legal frameworks appropriate for a market economy.

The Baltic countries have been successful in stabilizing their economies despite onerous initial conditions. By the end of 1992, all three had largely completed price liberalization. Following initial price adjustments, inflation began to subside in Estonia and Latvia in late 1992, and more recently it has also slowed in Lithuania. The speed with which real wages adjusted to the terms of trade shock and falling output varied in the three countries.

Changing Trade Patterns

In response to trade disruptions with the former Soviet Union, the Baltic countries shifted their foreign trade to other markets. They have remained highly competitive vis-à-vis industrial countries, and, as a result, in 1992, Latvian and Lithuanian export volumes to industrial countries doubled, and Estonian exports to these markets nearly tripled. In the first quarter of 1993, some 70 percent of Estonia's exports, over 60 percent of Lithuania's exports, and 45 percent of Latvia's exports were directed to markets other than the former Soviet Union.

Despite the shift in the pattern of exports, Baltic industries suffered from an overall shrinkage of markets and weak domestic demand. In 1993, real GDP is expected to decline by no more than 3 percent in Estonia, and by about 10 percent in Latvia and Lithuania, compared with a decline of 13 percent expected in the countries of the former Soviet Union as a group. These growth differentials reflect the relative steepness of the initial fall in output in response to the collapse of the Soviet planning system: real GDP fell sharply in the Baltic countries in 1991 and 1992.

Difficulties in Achieving Structural Reforms

Less progress has been made in the area of structural reforms. Privatization has been slow because of political difficulties associated with restitution. As in other economies in transition, privatization of small enterprises has proceeded more rapidly than privatization of large enterprises. All three countries have created two-tier banking systems, but bank supervision has remained weak.

In other areas of structural policies, progress has been better. New bankruptcy laws have been introduced, and their enforcement has increased the financial discipline of enterprises, particularly in Estonia. Governments have also introduced new competition laws in each country, and new accounting standards are being adopted.

The experiences of the Baltic countries underline the importance of speed, consistency, and determination in the implementation of stabilization and reform policies. Despite several changes in the political environment and government coalitions of each country, the basic stance of policies has closely followed the original strategy. Policy slippages have mostly been corrected swiftly, and the adopted policies have greatly improved macroeconomic stability. The task ahead is to consolidate the gains in stabilization and to expedite and broaden the structural reform process to ensure a revival of growth and employment over the medium term. In view of past policy performance, the prospects for such a turnaround are promising.

Natural Gas: The Demand for Energy Finds a New Outlet

For the past twenty years, natural gas has languished in the wings, playing understudy to the big star of the energy world, oil. But now, according to Thomas P. Enger, author of *The World Market for Natural Gas: Macroeconomic and Financial Implications*, natural gas may be moving closer to center stage. Enger's paper, part of the IMF Papers on Policy Analysis and Assessment series, takes a look at the likely effect of the development of a major market for natural gas on world commodity trade, capital movements, and macroeconomic and financial behavior.

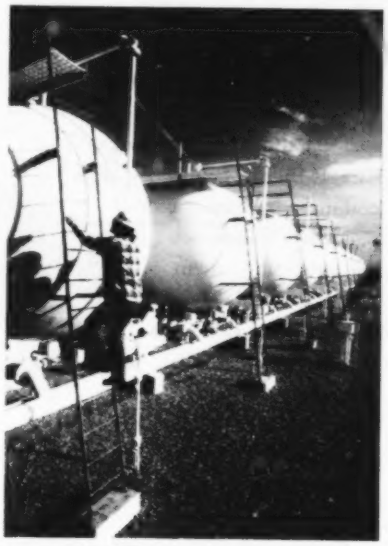
The major changes that have turned the spotlight on natural gas include

- concern over the quality of the environment;
- safety problems associated with nuclear energy;
- energy diversification policies;
- development of Eastern European economies with rich reserves of gas; and
- technological changes in the electric power industry.

How Gas and Oil Stack Up

As a result of intensive exploration over the last decade, proven world reserves of natural gas are now at a level close to those of crude oil. Further, according to Enger, "the average growth rate of proven gas reserves in recent years has been more than double that of oil reserves," and this trend is likely to continue.

Gas reserves are far more widely dispersed than oil reserves, which, the author notes, will have "major implications for the evolution of international trade in the two markets." About 65 percent of the world's oil reserves are in the Middle East, but only about 30 percent of gas reserves are. The Russian Federation holds the largest concentration of global gas reserves—39 percent; North America accounts for about 5 percent, and the remaining amounts are scattered around the globe.



The natural gas industry could have a major influence on future world trade and finance.

Consumption of oil and coal still exceeds consumption of natural gas, but the rate of consumption of natural gas has risen steadily from 1980 to 1991, whereas the rate for oil has fallen behind. From 1980 to 1990, the cumulative increase in total energy consumption was less than 20 percent; gas consumption soared ahead of oil, rising by 39 percent, compared with only a 3.8 percent increase for oil.

The trade figures from 1985 to 1991 paint a similar picture: although trade in oil and refined products was still much higher than for gas, the increase in trade in natural gas (39 percent) outstripped that of oil (29 percent). The Russian Federation was the largest exporter of natural gas in the years 1985 to 1991, and Western Europe was the largest importer.

Why Gas Is Heating Up the Energy Market

Natural gas production is highly capital-intensive. Construction of the gas infrastructure is, according to Enger, "a massive financial undertaking," requiring very large investments in fixed capital stock. Nevertheless, the world's increasing energy requirements and the risks, costs, and availability associated with other forms of energy may combine to promote natural gas from bit player to principal actor on the world energy scene.

The demand for gas, says Enger, depends on "prices, tastes, and trends in national income," and changes in these determinants help to explain the recent rapid growth in the demand for gas.

Developments and prices in the oil market have a direct and heavy influence on gas prices. But, says Enger, several signs point to the possibility that "gas prices will be somewhat more independent of oil prices in the future":

- Gas prices have followed a downward trend in the past twenty years as supplies have increased.
- The oil price shock in the 1970s led a number of heavy energy users to explore alternate sources of energy as a means of protecting themselves from reliance on a single source or from being held hostage by a single region.
- Up until the late 1980s, the natural gas industry was subject to pervasive

government regulation. Energy reform policies in the main energy importing countries included considerable relaxation of government regulation, thus freeing up the industry and making it more competitive with oil.

• Natural gas, which produces fewer sulphur and nitrogen emissions than either coal or oil and does not pose the same risks as nuclear energy, is probably the energy source best suited to meet the rising public concern about the environment.

Macroeconomic Implications

The growth of the world gas industry, says Enger, "can dramatically improve the export prospects of those countries, such as the Russian Federation, with high proven reserves over the longer term." But because natural gas projects are highly capital intensive, "large foreign investment flows are likely to be a major factor in the future development of the market's export capacity." It thus is likely that those regions and countries with large gas reserves will require large and sustained inflows of capital goods. It therefore behooves the governments in these countries to provide a "regulatory environment conducive to large and sustained inflows of foreign investment."

Future Trends in the Industry

According to Enger, the gas industry will become more internationally integrated as it undergoes development and growth and will thereby exert a major influence on world trade and finance—equal, possibly, to that of the world oil market. Unlike the oil market, however, developments in natural gas are likely to exert this influence not through short-term price shocks, but rather "on the level and geographic pattern of international trade, investment, and financial flows."

New Currencies: Experiences In the Former Soviet Union

(continued from front page) inflation within the former Soviet Union and uncertain prospects for any early amelioration of such pressures.

• To build on monetary stability to achieve broader policy goals, especially the promotion of an early recovery in growth and employment and a faster pace of transition to a market economy.

Country Experiences

The IMF has helped all five countries introduce independent currencies by providing them with technical advice. In the Baltic states and the Kyrgyz Republic, it has also collaborated with the authorities on the design of monetary and fiscal policies to support the new currencies while also providing financial assistance.

Estonia, which achieved early exchange rate stability by pegging its currency to the deutsche mark in the context of a currency board (see page 366), established control over credit creation by implementing balanced general government budgets in both 1992 and 1993, and by eliminating all central bank credit to enterprises. It had also largely completed the process of decontrolling prices by the time the kroon was introduced and then implemented a tax-based incomes policy to help contain any continuing pressure from wages.

The Estonian authorities simultaneously liberalized external trade and payments arrangements and introduced bold structural reforms, including the privatization of large enterprises and implementation of an effective bankruptcy law in September 1992. In the event, Estonia's average monthly inflation rate fell to below 2 percent by mid-1993, and exchange rate stability inherent in the deutsche mark peg contributed to a sharp reorientation of trade from the former Soviet Union to industrial countries. The burgeoning private sector and growth of exports to industrial countries encouraged inward investment and permitted a modest recovery in output beginning in mid-1993.

Five new currencies (back to front): Estonian kroon, Latvian lats, Ukrainian karbovanets, Lithuanian litas, and Kyrgyz som.

The *Kyrgyz Republic* also introduced its own currency with the support of a comprehensive stabilization program—including a reduction in the fiscal deficit, achieved primarily by limiting both transfers and lending to state enterprises. This was accompanied by a tightening of monetary policy and a liberalization of prices.

Photo Credits: Abbas for Magnum, page 355; Vince Streano for Tony Stone Images, page 359; Padraic Hughes for IMF, page 360.

The authorities reimposed price controls on many goods, however, after introducing the som. As a result, abrupt upward adjustments in administered prices later proved necessary. In addition, the economy was buffeted by a variety of external shocks—including sharp increases in energy prices and strained trading relations (that were not directly attributable to the introduction of the som) with neighboring countries, as well as shortfalls and delays in foreign financing. Together with a loosening of financial policies in the third quarter of 1993, these factors contributed to monthly inflation rates ranging between 15 percent and 30 percent through October 1993. Problems with restraining inflation also contributed to a depreciation of the som against the U.S. dollar. At the same time, output is estimated to have continued falling through mid-1993, partly reflecting the collapse of traditional export markets and trading relationships.

The centerpieces of *Latvia's* stabilization effort were the maintenance of a tight monetary policy supported by a broadly balanced government budget, significant price liberalization prior to the introduction of the national currency, and the freeing of the external trade and payments regime. This effort was complemented by a tax-based incomes policy.

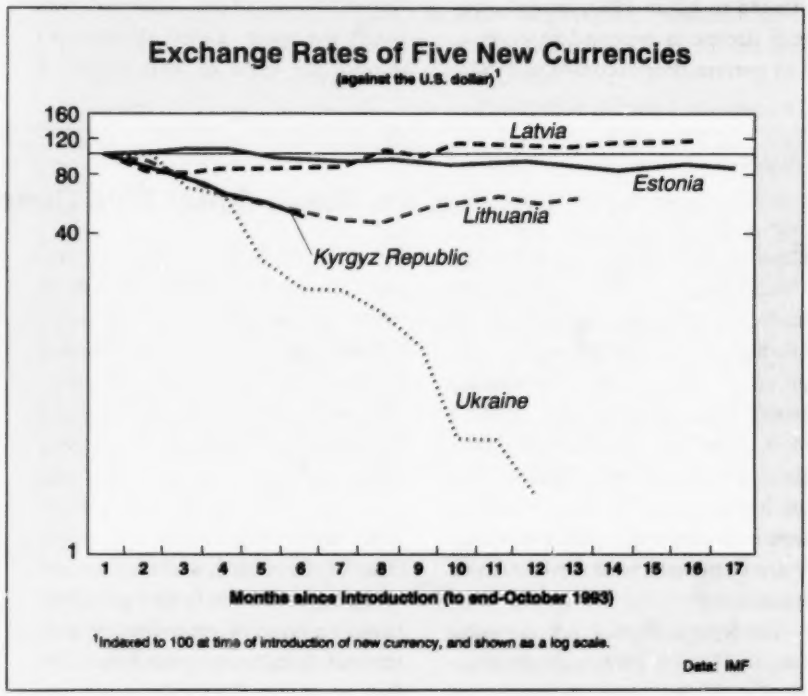
Latvia also made considerable progress with structural reforms. Concerted implementation of this reform program permitted a sharp decline in the rate of monthly inflation to the low single digits throughout 1993, compared with 20 percent in July 1992. Unlike in Estonia, the exchange rate was largely left to be determined by the market. Once the credibility of the stabilization effort was established, capital inflows led to a sizable appreciation of the lats against the U.S. dollar (beginning in late 1992). Meanwhile, after a precipitous fall in 1992, the decline in output seems to have ended, and a recovery, led by exports and investment, now appears to be under way.

As in the other Baltic states, the stabilization program in *Lithuania* emphasized maintaining broadly balanced budgets in 1992 and 1993. The authorities substantially freed external trade and payments and bolstered the anti-inflationary policy with a tax-based incomes policy. They also actively pursued structural reform measures, including full privatization in the housing sector.

The abatement of inflation in Lithuania took somewhat longer than in the other two Baltic states because of an unexpected monetary expansion in late 1992 that was not immediately reversed. In April and May 1993, however, the authorities further tightened monetary policy, including by nearly trebling commercial bank reserve requirements. As a result, monthly inflation fell to less than 3 percent by mid-1993 and was accompanied by a rapid appreciation of the talonas (later replaced by the litas).

In *Ukraine*, the karbovanets was introduced without the support of appropriate monetary and fiscal policies. On the contrary, the new currency's availability was taken as an opportunity to overcome the few restraints on credit expansion that existed within the ruble area. The authorities' retention of price controls combined with underlying inflationary pressures required repeated adjustments to administered prices; the resulting upward price shifts were accommodated by wage adjustments, lax budgetary controls, and successive rounds of credit expansion.

The authorities did not introduce a well-ordered, market-based foreign



exchange system until March 1993, and in August 1993 they reverted to a multiple exchange rate system. The authorities took no effective measures to accelerate structural reforms in the economy. The end result has been inflation averaging more than 40 percent a month in the first ten months of 1993 and a sharp depreciation of the karbovanets against both the U.S. dollar and the ruble, especially since the introduction of multiple exchange rates. At the same time, output has continued to fall in 1993; indeed, the overall decline is expected to exceed the 15 percent drop recorded in 1992.

Policy Lessons

The experience of these five countries strongly suggests that following the introduction of a new currency, the implementation of appropriate macroeconomic and structural policies is necessary to stabilize prices and achieve an early return to economic growth and rising incomes and employment. Output declined in 1992 by more in the Baltic states—which have implemented supporting policies most rigorously—than in the rest of the former Soviet Union. This, however, was largely the result of their absorbing all at once the terms of trade impact of moving to world energy prices. Indeed, in response to firm stabilization policies, by mid-1993 the fall in output in the Baltics had been arrested and some recovery may have begun, whereas in the rest of the former Soviet Union, output decline has continued unabated.

Evidence suggests that the actual introduction of a national currency is relatively easy to achieve; it involves mainly technical questions related to issuing and distributing the new currency. The much harder part is achieving monetary stability through the design and implementation of an appropriate stabilization program. The

Leaving the Ruble Area: Five Case Studies

Estonia left the ruble area on June 20, 1992, with the introduction of its national currency, the "kroon," as the sole legal tender. The kroon was introduced in the context of a currency board and pegged to the deutsche mark at the rate of EEK 8 per DM1. Since the kroon's introduction, Estonia has maintained a liberal exchange regime for current account transactions and progressively freed capital account transactions.

The Kyrgyz Republic left the ruble area on May 14, 1993, with the introduction of its national currency, the "som," as the sole legal tender. The som was allowed to float freely. Its initial exchange rate was about Som 4 per US$1, and at the end of October 1993, the rate was Som 7.65 per US$1. Since the som's introduction, the Kyrgyz Republic has maintained a liberal exchange regime for both current and capital account transactions.

Latvia introduced the "Latvian ruble" on May 7, 1992, to circulate in parallel, and valued at par, with the Russian ruble. Latvia left the ruble area on July 20, 1992, when the Latvian ruble was made the sole legal tender. The Latvian ruble was allowed to float, with the central bank intervening in smoothing operations. In March 1993, the Latvian ruble was converted into the "lats" at a fixed conversion rate of 200 Latvian rubles per Ls 1. The initial exchange rate in July 1992 was about Ls 0.68 per US$1 (correcting for the conversion from Latvian rubles), and as of the end of October 1993 was Ls 0.61 per US$1. Latvia removed all restrictions on current and capital account transactions before introducing the Latvian ruble.

Lithuania introduced the "talonas" on May 1, 1992, to circulate in parallel, and valued at par, with the Russian ruble. It left the ruble area on October 1, 1992, when the talonas was made the sole legal tender. The talonas was allowed to float, with the central bank intervening occasionally in smoothing operations. On June 25, 1993, the talonas was replaced by the litas at a fixed conversion rate of 100 talonai per Llt 1. The initial exchange rate in October 1992 was about Llt 2.5 per US$1 (correcting for the conversion from the talonas), and as of the end of October 1993, the rate was Llt 3.9 per US$1. Lithuania lifted all restrictions on current and capital account transactions prior to leaving the ruble area.

Ukraine introduced its coupon currency on January 1992, to circulate in parallel, and valued at par, with the Russian ruble. Ukraine left the ruble area on November 16, 1992, with the introduction of its national currency, the "karbovanets," as the sole legal tender. Ukraine had in place a multiple exchange rate system at the time the karbovanets was introduced. The authorities unified the exchange rate in March 1993, implementing a liberal regime for current account transactions but retaining some restrictions with regard to capital account transactions. In August 1993, however, the authorities reintroduced a multiple exchange rate system. The initial exchange rate of the karbovanets was about Krb 700 per US$1, and the rate as of the end of October 1993 was Krb 31,000 per US$1.

key element here is establishing firm control over the money supply at the outset of the program. With few or no markets in financial instruments in the former Soviet Union, control over money implies control over credit creation. This, in turn, requires strict control over government finances, combined with restraint on central bank financing of commercial banks and the enterprise sector.

The Baltic states' experience demonstrates that general government budgets can be balanced, and such balance can be maintained, even during periods of sharp output declines. In contrast, in Ukraine, the consequences of failing to contain fiscal deficits are all too apparent. Overall, given the uncertain prospects for monetary stabilization in Russia and elsewhere in the former Soviet Union, the implementation of sound fiscal and monetary policies and the achievement of price stability may be problematic unless national currencies are introduced.

In addition, rapid completion of price liberalization, preferably prior to the introduction of the new currency, is vital. The retention of price controls or budgetary subsidies after the introduction of the new currency—such as in the Kyrgyz Republic and Ukraine—stores up trouble for the future, with potentially dangerous episodes of large upward price adjustments that could undermine confidence in the new currency.

Price stability is an essential condition for the sustained growth of output and employment. No economy in transition has experienced a recovery in output without a substantial reduction in inflation. But this is only one of the conditions. Measures to speed the transition to a market economy are also critical. First steps include the introduction of a liberal exchange and trade regime to foster confidence in the currency and encourage domestic competition. At the same time, it is necessary to provide for the ready convertibility of the currency at a unified exchange rate for current account transactions to help achieve acceptability of the new currency. The experience of the Baltics demonstrates that liberalization of exchange and trade policies, combined with successful stabilization, is likely to lead to capital inflows and to the contribution by the export sector to an early output recovery.

Finally, the authorities need to implement structural and institutional reforms that allow the private sector to respond effectively to new opportunities. The experiences of all three Baltic states also underscore the importance of eliminating obstacles to the growth of the service sector (especially the small-scale retail sector)—which was underrepresented in the former Soviet economy—so that it can grow rapidly and help absorb labor displaced from large manufacturing enterprises undergoing restructuring.

In conclusion, the introduction of a national currency can facilitate early success in reducing inflation, thereby laying the groundwork for economic growth and integration into the world economy. A new currency is not, however, a panacea for the problems associated with making a transition to independence and a market economy. To be successful, supporting policies—including appropriate structural measures—must be gotten right and must be implemented rigorously.

Basil B. Zavoico and Daniel A. Citrin,
IMF, European Department II

IMF Supports Introduction of New Currencies, Says Camdessus

Since July, a number of states of the former Soviet Union have sped up introduction of their own currencies. Turkmenistan introduced its currency on November 1, and Moldova plans to do so by the end of November. Kazakhstan and Armenia have just introduced their own currencies, and several other states have taken steps toward introducing coupons or other types of independent currencies.

In a statement issued by the IMF on November 15, Managing Director Michel Camdessus, noting these recent developments, expressed the IMF's support for the moves toward introduction of national currencies. These moves, he said, "if accompanied by adequately restrained monetary and fiscal policies, as well as liberalization of the trade and payments system, will enable these states to have independent control over their financial situation, to make progress toward reducing inflation, and to lay the foundation for sustained economic growth in the period ahead in the framework of close regional cooperation."

Camdessus welcomed the ongoing efforts to strengthen economic links among the states of the former Soviet Union.

The IMF is prepared to extend financing to those states that introduce their own currencies—and that face balance of payments problems—provided they pursue the necessary reform and stabilization policies, said Camdessus. He hoped that donor institutions and governments would do so as well, and said that the IMF would maintain its close contact with the states of the former Soviet Union.

Spotlight on Latin America: Moving into the Next Century

In the past two decades, the countries of Latin America have undergone radical economic, political, and social change. Over the same two decades, the global community has grown more complex and interdependent, and countries and regions can no longer survive or prosper outside that community.

Latin America thus faces a twofold challenge in the coming years: to create a stable and socially effective domestic economy that at the same time enriches and is enriched by the global economy. On September 26, Enrique V. Iglesias, President of the Inter-American Development Bank, addressed this issue in the 1993 Per Jacobsson Lecture, "Latin America: Economic and Social Transition to the Twenty-First Century."

The New, Interdependent World

Iglesias outlined several major developments in the global economy that have a direct bearing on the economic, political, and social agenda of the individual members of the global economy.

• ***Globalization in production and finance.*** The phenomenal growth of transnational corporations and international financial markets has effectively broken down national boundaries.

• ***Major fiscal and trade imbalances.*** Since 1982, large fiscal and foreign trade deficits run up by the key industrial countries have upset the relatively stable trends of the previous thirty years and given rise to protectionist pressures and tensions in the international monetary system.

• ***Savings and macroeconomic disequilibria.*** According to Iglesias, one of the most momentous changes of our times has been the sharp decline in average savings in the industrial countries and the conversion of some of the centrally planned economies from net creditor to net debtor nations.

Enrique V. Iglesias, President, Inter-American Development Bank.

The Postwar Growth Model

In the years immediately following World War II, the countries of Latin America adopted the prevailing economic philosophy, dominated by the New Deal and Keynesian economics. The fundamental premises of this philosophy, Iglesias said, included a "recognition of the crucial role played by capital and the importance of assimilating modern technology."

This model encouraged industrialization based on import substitution as a means of satisfying rising demand within the confines of strict balance of payments constraints and protectionist policies worldwide. The state was expected to take on an active role in economic and social development and to manage directly a major share of the productive resources.

What Went Wrong?

The framers of the Latin American growth strategy of the 1950s and 1960s should not be faulted for their attempt to follow the then-prevailing recipe for economic success. In fact, according to Iglesias, in the years 1961–70, many, if not all, of the Latin American countries achieved significant improvements in economic and social conditions.

By the beginning of the 1970s, however, underlying fault lines in the strategy began to break up the economic landscape. Major elements in the strategy proved to be counterproductive:

• ***Import substitution.*** The objective of increasing and diversifying exports was not yet realized, but policymakers continued to pursue the goal, which resulted in depressed export capacity and loss of international competitiveness.

• ***Social objectives.*** Populist income redistribution measures benefited the middle and upper classes, contributed to inflation, and worsened the condition of the majority of the population.

• ***A large and inefficient public sector.*** Inflexible public administration, lack of competition among manufacturers, and inelastic tax systems produced, according to Iglesias, "a growing tolerance of fiscal imbalances and inflation," which limited the ability of governments to direct development. Only external borrowing at the end of the 1970s and growing inflation during the decade were able to hold off the "day of reckoning." But the day of reckoning

dawned nevertheless, as the old development strategy sank under the weight of a crushing debt service, sharply reduced inflows of new external resources, capital flight, shrinking imports, cutbacks in economic and social investment, dismantling of assets, additional losses in international competitiveness, and a crisis in public institutions.

The New Strategy

The debt crisis of the 1970s, although painful, had some salutary effects, according to Iglesias. It forced the region to take a long, hard look at its development strategy. The international relationships that it developed between governments, creditor banks, and international agencies helped the region to become fully aware of the need to make sweeping changes to its economic strategy, and of its "indissoluble ties" to the international economic system.

In the 1980s, the countries of Latin America introduced a number of wide-ranging political, economic, and social policies. Iglesias cited three objectives common to the strategies of almost all the countries:

- Price stability through macroeconomic balances grounded on efficient markets.
- External openness in international trade, financing, investments, and technological innovation.
- Modernization of the state and of public policies through cutbacks in the public sector, simplification, and relaxation of controls.

Early Returns and Prospects

So far, the strategy appears to be paying off. The region's economy is growing at an annual average rate of 3 percent of GDP, and prospects for further growth are good. On the external front, capital is once more flowing freely into Latin America, and domestic capital, which fled in the 1970s and 1980s, is coming home again.

"The reforms are on the right track," Iglesias said, but there are some weaknesses inherent in the strategy, and these need to be met head on if the strategy is to realize its full potential:

- The compass of the economic reforms is too limited; it needs to be both broadened and deepened.
- Domestic savings are too low. Thus, a better investment climate is the key to Latin American development.
- Social reforms must be consonant with the programs aimed at modernizing the economy. According to Iglesias, "40 percent of the region's population earns less than a minimum wage, and a very large number are living in extreme poverty."

Finally, the success of Latin America's development strategy depends crucially on the response of the international community. Sluggish growth in the industrial countries, coupled with the threat of protectionist barriers against Latin America's traditional and nontraditional exports, can effectively short-circuit even the most determined and farsighted development strategy.

"Such threats," Iglesias concluded, "are particularly disheartening" when the international community is "exhorting the developing economies to modernize, to lower barriers to trade, and to join in the movement toward international integration."

SDR Rates

Week Beginning	Interest and Charges (percent)
Nov. 15	4.09
Nov. 22	4.05

The rate of SDR interest and charges is calculated weekly, by reference to a combined market interest rate, which is the weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket (U.S. dollar, deutsche mark, Japanese yen, French franc, and pound sterling). The interest rates used are those that prevail each Friday. For the latest weekly rates call (202) 623-7171.

Data: IMF Treasurer's Department

IMF ACTIVITIES

From the Executive Board . . .

Barbados: Acceptance of Article VIII. The Government of Barbados has notified the IMF that it has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement, with effect from November 3, 1993. IMF members accepting the obligations of Article VIII undertake to refrain from imposing restrictions on the making of payments and transfers for current international transactions or from engaging in discriminatory currency arrangements or multiple currency practices without IMF approval. Barbados is the eighty-second member of the IMF to assume Article VIII status.

Two of the main purposes of the IMF, as stated in its Articles of Agreement, are to facilitate the expansion and balanced growth of international trade, and thereby to contribute to the promotion and maintenance of high levels of employment and real income; and to assist in the establishment of a multilateral system of payments in respect of current transactions between IMF members. In seeking to achieve these objectives, the IMF exercises firm surveillance over the exchange rate policies of its members and oversees the elimination of exchange restrictions that hamper the growth of world trade.

By accepting the obligations of Article VIII, Barbados gives confidence to the international community that it will pursue sound economic policies that will obviate the need to use restrictions on the making of payments and transfers for current international transactions, and thereby contributes to a multilateral payments system free of restrictions.

Barbados has been a member of the IMF since December 29, 1970, and its quota in the IMF is SDR 48.9 million (about $68.0 million).

Press Release No. 93/49, November 12

NATIONAL ECONOMIES

Estonia's Currency Board Anchors Its Economy As Adjustment Proceeds

Estonia's decision to leave the ruble area in June 1992 and introduce its own currency—the kroon, whose exchange value is guaranteed by a currency board—has promoted the stabilization and restructuring of its economy, according to Siim Kallas, Governor of the Bank of Estonia. Speaking at a seminar held at the World Bank on September 24, 1993, Kallas discussed how the currency board had been established and how it had operated during its first 15 months. He concluded that it would remain in force to anchor the Estonian economy as it continues to develop.

Background

An earlier incarnation of the kroon, pegged to the Swedish krona on a 1:1 basis, had served as Estonia's currency from 1928 until 1940. In 1940, Estonia became part of the former Soviet Union, and the ruble was introduced. In 1992, after Estonia had once again become an independent country, the Bank of Estonia decided to peg the kroon to the deutsche mark at the rate of 8 krooni to 1 deutsche mark (DM 1 = EEK 8). This rate was based on the market rate between the ruble and the deutsche mark at the time of the kroon's introduction and was initially set at 10 rubles for 1 kroon, which yielded roughly the 8:1 peg of the kroon to the deutsche mark. Kallas emphasized that although Estonia had sought to introduce an exchange rate that reflected market realities, the precise rate between the kroon and the deutsche mark it had selected was not nearly as important as the currency board's determination to maintain the rate chosen.

How the Currency Board Operates

From its inception, the currency board has guaranteed the exchange value of all kroon notes and kroon-denominated central bank deposits of the domestic banking system. Using gold Estonia had deposited with the Bank of England, Swedish banks, and the Bank for International Settlements before World War II (and recovered after reestablishing its independence) to back up this pledge, the Bank of Estonia freely sold deutsche mark bank notes in exchange for kroon bank notes, and vice versa, to all comers without limit. All other kroon-deutsche mark exchange transactions were handled via bank accounts. The kroon's 8:1 peg to the deutsche mark can be changed only by Estonia's parliament.

Estonia decided that in order to maintain the currency board's integrity, it could not be permitted to engage in general discretionary lending to commercial banks. The Bank of Estonia was therefore split into two departments. The Issue Department runs the currency board, and the Banking Department is responsible for other central banking functions, including payments arrangements with the states of the former Soviet Union and provision of emergency loans to the banking system. The Issue Department holds enough foreign exchange to back all of its kroon liabilities, and any excess foreign exchange it accumulates is transferred to the Banking Department.

Because the Estonian banking system was underdeveloped and did not have the full confidence of the public at the time the currency board was introduced, a system of capital controls was set up to support it. These restrictions have been eased as the board has gained operating experience. Surrender requirements for foreign exchange were dropped after six months, and the only remaining prohibition—on Estonian citizens having foreign-currency accounts in domestic is expected to be eliminated shortly.

One prerequisite for the successful operation of a currency board is that the country's central bank not be able to lend to the government. The Bank of Estonia is therefore prohibited from doing this; if the Government needs domestic financing, it must borrow from the commercial banking system. The central bank also, as a matter of policy, does not engage in open market operations, administrative guidance, or the sterilization of foreign currency inflows. Interest rate levels and the yield curve in Estonia are therefore genuinely market-determined.

In his presentation, Governor Kallas noted that before the kroon was introduced, it was widely expected that the new currency would not be able to serve as the country's sole legal tender; parallel circulation of hard currencies was envisaged, but this has not occurred. Likewise, many feared that the introduction of the kroon would bring about an outflow of foreign reserves. Instead, there has been a net inflow. Kallas also pointed out that the Bank of Estonia has enjoyed strong public

and parliamentary support. In June 1993, parliament passed without opposition a law guaranteeing the independence of the Bank, thereby assuring it a position of considerable influence in the country's financial system.

When Estonia experienced a crisis in its banking system in late 1992 and early 1993, Kallas observed, the Bank of Estonia chose to let several banks with weak balance sheets fail rather than engage in emergency lending to them, and the country's financial system successfully weathered the storm. The Bank's handling of the crisis, he said, had considerably strengthened the financial discipline of Estonian commercial banks and demonstrated the Bank's ability to operate within the limitations required for the currency board to operate.

Estonia's Approach to Reform

Kallas noted that Estonia had coupled the introduction of the kroon with a very tight fiscal policy and a liberal, outward-oriented economic policy. He noted that both the public and leading politicians have accepted the necessity for the Government to operate with a balanced budget. The continued stability of the kroon, he said, has brought about many changes for the better in Estonia's economy. And the kroon's stable exchange rate had boosted entrepreneurs' confidence in the economy. In addition, people's ability to earn money and use it without restrictions had "created a new motivation to work" in Estonia, and the availability of consumer goods has increased considerably under the influence of ongoing economic reforms.

Currency Units per SDR

NOVEMBER

Currency	3	4	5	8	9	10	11	12	15	16
Deutsche mark	2.35748	2.35192	2.358	2.35284	2.34539	2.35343	2.35459	2.36877	2.35753	2.36342
French franc	8.22367	8.20418	8.20379	8.1621	8.1868	8.22151	...	8.22524	8.21282	8.20784
Japanese yen	...	149.612	150.403	150.702	149.803	149.811	149.217	148.341	148.071	148.777
Pound sterling	0.938683	0.938287	0.938426	0.939161	0.94128	0.945808	0.943617	0.941962	0.93809	0.937378
U.S. dollar	1.39019	1.39101	1.38812	1.39024	1.39093	1.391	1.39325	1.39222	1.39868	1.39435
Argentine peso	...	...	...	...	...	...	...	...	...	...
Australian dollar	2.06382	2.06198	2.05953	2.06835	2.06892	2.0864	2.1062	2.09672	2.1408	2.12294
Austrian schilling	16.5989	16.6067	16.5866	16.548	16.5006	16.5571	16.563	16.6287	16.5865	16.6248
Bahrain dinar	0.522711	0.52302	0.521933	0.52273	0.52299	0.523016	0.523662	0.523475	0.525979	0.524276
Bangladesh taka	55.3991	55.4317	55.3166	55.4011	55.4286	55.4314	55.521	55.48	55.7454	55.5648
Belgian franc	50.4485	50.3859	50.3992	49.9374	49.8996	50.469	...	50.4993	50.4506	50.2454
Brazilian cruzeiro	245.626	249.554	252.936	257.187	261.297	269.43	274.041	273.839	...	278.526
Canadian dollar	1.8199	1.81457	1.79612	1.80169	1.81795	1.81996	...	1.82673	1.84988	1.83915
Colombian peso	1250.77	1252.09	1250.13	1134.02	1253.98	1254.71	1257.34	1257.11	...	1259.67
Danish krone	9.438	9.40114	9.40312	9.35771	9.33314	9.39481	9.39536	9.41629	9.41796	9.41117
Finnish markka	8.03669	8.00304	8.01181	7.99636	8.01064	8.0454	8.07625	8.1023	8.14288	8.1246
Greek drachma	337.719	336.861	337.376	336.8	336.09	336.935	337.724	336.901	336.319	336.548
Indian rupee	43.6103	43.636	43.5453	43.6118	43.6335	43.6357	43.7063	43.6739	43.8829	43.7408
Indonesian rupiah	2926.35	2926.69	2921.99	2923.67	2922.34	2922.49	2924.43	2920.88	2934.85	2925.35
Iranian rial	2313.28	2308.72	...	2295.95	2306.41	2322.85	2335.49	2335.49	2357.03	2268.3
Iraqi dinar	0.432151	0.432406	0.431507	0.432168	0.432381	0.432403	0.433102	0.432782	0.434852	0.433444
Irish pound	0.993774	0.990254	0.991585	0.986896	0.992458	0.992721	0.991143	0.995083	0.991551	0.991009
Italian lira	2275.36	2282.84	2286.91	2286.54	2295.47	2301.6	2297.93	...	2326.7	2323.21
Korean won	1122.3	1122.96	1120.35	...	1122.9	1122.95	1123.52	1121.29	1127.36	1125.1
Kuwaiti dinar	0.41607	0.415745	...	...	0.41554	...	...	...	0.417118	0.416046
Libyan dinar	0.446429	0.446429	0.446429	0.446429	0.446429	0.446429	0.446429	0.446429	0.446429	0.446429
Malaysian ringgit	3.56097	3.55445	3.55012	3.55206	3.55174	3.54775	3.5493	3.54766	3.56407	3.5528
Maltese lira	0.545772	0.543363	0.543466	0.542448	0.542104	0.545063	0.544387	0.545263	0.544758	0.545179
Nepalese rupee	68.453	68.4933	68.351	68.4554	68.4894	68.4928	68.6036	68.5529	68.8809	68.6578
Netherlands guilder	2.64664	2.64	2.64617	2.6352	2.63929	2.64554	2.64266	2.65568	2.64668	2.65177
New Zealand dollar	2.50801	2.50723	2.49438	2.54716	2.55404	2.55981	2.58105	2.57532	2.60402	2.58932
Norwegian krone	10.2547	10.2211	10.2332	10.2051	10.1955	10.2524	10.255	10.2808	10.265	10.2631
Omani rial	0.534528	0.534843	0.533732	0.534547	0.534813	0.53484	0.535705	0.535309	0.537989	0.536128
Pakistan rupee	41.8798	41.9045	41.8174	41.8813	41.902	41.9042	41.9719	41.9409	42.1415	42.0051
Portuguese escudo	242.713	241.317	241.742	241.444	239.977	241.108	242.391	241.694	241.511	240.332
Qatar riyal	5.06029	5.06328	5.05276	5.06047	5.06299	5.08324	5.07143	5.06768	5.09192	5.07543
Saudi Arabian riyal	5.20626	5.20933	5.19851	5.20845	5.20903	5.2093	5.21772	5.21386	5.23681	5.22184
Singapore dollar	2.21235	2.21115	2.211	2.21576	2.21547	2.21378	2.21619	2.21962	2.2259	2.2219
South African rand	4.67868	4.67449	4.67449	4.66912	4.66866	4.68032	4.66202	4.6883	4.70064	4.68571
Spanish peseta	188.635	188.273	189.215	188.238	...	189.301	190.025	190.666	191.703	191.165
Sri Lanka rupee	68.5433	68.5525	68.4392	68.5215	68.5348	68.5728	68.6696	68.619	68.8983	68.7031
Swedish krona	11.3537	11.336	11.3201	11.2602	11.3283	11.4278	11.486	11.5025	11.489	11.433
Swiss franc	2.08607	2.08721	2.08704	2.07424	2.08734	2.07398	2.07803	2.09529	2.08503	2.08246
Thai baht	35.2413	35.2482	35.2027	35.2565	35.2462	35.2619	35.2771	35.2371	35.3777	35.3189
Trinidad and Tobago dollar	7.94505	7.9421	7.93296	7.92554	7.93644	7.95343	7.94097	7.94465	7.98145	7.96376
U.A.E. dirham	5.10339	5.1064	5.09579	5.10357	5.1061	5.10636	5.11462	5.11084	5.13529	5.11888
Venezuelan bolivar	139.714	140.005	139.922	140.275	140.553	140.7	...	141.032	141.916	141.805

Notes: 1. The value of U.S. dollar in terms of the SDR is the reciprocal of the sum of the dollar values, based on market exchange rates, of specified quantities of the first five currencies shown. The exchange rates used for this purpose are noon rates in the London foreign exchange market. When the London market is closed, noon rates in the New York market are used. Frankfurt fixing rates are used when the New York market is closed. 2. The value in terms of the SDR of each of the other currencies shown above is derived from that currency's representative exchange rate against the U.S. dollar as reported by the issuing central bank and the SDR value of the U.S. dollar, except for the Iranian rial and the Libyan dinar, the values of which are officially expressed directly in terms of the domestic currency units per SDR.

Data: IMF Treasurer's Department

Kallas also noted that the Government was attempting to restructure Estonia's economy to make it more closely resemble those of Western industrial countries. On this point, he noted that the share of manufac[turing] was declining, whi[le] trading and service[s]

Exports to cou[ntries] of the former [Soviet Union] creased rapi[dly] first half of [1993] second ha[lf] lion in the [first] Finland is now E[stonia's largest] trading partner, and Estonia's t[rade with Russia] now accounts for a much [smaller] share of both its exports and imports [than] did two years ago. Kallas comme[nted] that Estonia's long-standing participation in the Soviet trade system had posed considerable difficulties as it attempted to reorient its economic and trade policies after achieving independence. At the same time, however, he emphasized the Government's interest in expanding trade with Russia if trade relations could be developed on a favorable basis, which should include both an adequate financial foundation and a market orientation.

Remaining Difficulties

Kallas observed that although Estonia's inflation had declined considerably in recent months, its inflation rate remained high by industrial country standards and, in particular, in comparison with that of Germany. Kallas also noted that Estonia's relative[ly] [low] [wa]ges [and] [pro]ductivity [were] [re]sponsible for [the] [pro]blem was [ex]acerbated by [the] [ex]change rate [of] [the] kroon, which [was] [fix]ed to the German mark. [Ka]llas [re]iterated [his] [co]nvictions that [the] [ec]onomic [en]vironment [in] [Es]tonia would be most effectively dealt [with] [in the] context of a growing and [mar]ket economy.

Estonia's banking system, Kallas noted, was currently characterized by small banks with limited capital bases. Their limited resources made it hard for them to lend money for building factories or other major capital projects. He noted that, in the aftermath of central planning, most business people were not financially sophisticated, and many banks were still in the process of establishing new customer relationships and improving their abilities to evaluate credit risks. The banks suffered from a lack of adequately trained managers, he said, and especially needed assistance in training lower-level bank personnel, such as accountants and clerks. Kallas noted [that] Estonian banks still [showed] reluctance to lend to [private] capital was often [kept] abroad when the country's [banking] needed investment.

[At this] point, Governor Kallas [said] country's privatization [was] [not] as successful as [officials] had hoped [but] acceleration of such [efforts]. He said that Estonia had no plans to discontinue its currency board, since it viewed maintenance of the kroon's exchange value as the keystone of its economic development efforts, and asserted that Estonia needed to both keep its exchange rate competitive and to have "absolutely free trade" as it continued to restructure its economy.

The IMF published its second economic review of Estonia in May 1993. It contains background information on Estonia and information on recent economic and financial developments there. The publication, No. 4 in the IMF's Economic Reviews series for 1993, was prepared by a staff team led by Adalbert Knöbl of the European II Department. Copies are available for $15.00 each from Publication Services, Box S-380, International Monetary Fund, Washington, DC 20431, U.S.A. (Telephone: (202) 623-7430; fax: (202) 623-7201.)

November 29, 1993 • Volume 22, Number 22

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The *IMF Survey* (ISSN 0047-083X) is published by the International Monetary Fund 23 times a year, ordinarily on alternate Mondays, in addition to an annual *Supplement on the Fund*, an annual Index, and other occasional supplements. Editions are also published in French (*Bulletin*) and Spanish (*Boletín*).The opinions and materials contained in the *IMF Survey*, including any legal aspects, do not necessarily reflect the official views of the IMF. Editorial correspondence should be addressed to Current Publications Division, Room IS5-1500, International Monetary Fund, Washington, D.C. 20431, U.S.A. Telephone: (202) 623-8585. The *IMF Survey* is distributed by first-class mail in Canada, Mexico, and the United States, and by airspeed elsewhere. Private firms and individuals are charged an annual rate of US$79.00. Apply for subscriptions to Publication Services, Box S-99, IMF, Washington, D.C., 20431, U.S.A. Telephone: (202) 623-7430. Cable: Interfund. Facsimile: (202) 623-7201.